

United States District Court, S.D. New York.

Robert SHAMIS, as Assignee of Wishbone Trading Company, Limited, a Hong Kong corporation, Plaintiff,

v.

AMBASSADOR FACTORS CORPORATION, d/b/a Ambassador Factors, a division of Finova Capital Corporation, a Delaware corporation, S. Roberts, Inc., a New York corporation, Jay Vee, Inc., a New York corporation, Christy Lynn, a New York corporation, Angela Christy, a New York corporation, ABC Companies (fictitious names of corporate affiliates of defendants S. Roberts, Inc. and Jay Vee, Inc. whose identities are presently unknown), Nathan Korman, a/k/a Lawrence Korman, and Mahoney Cohen Rashba Pokart & Company, a New York professional corporation, Defendants.

**No. 95 CIV 9818 RWS.**

Sept. 21, 2000.

Storch Amini & Munves, P. C., New York, NY, Counsel for Plaintiff.

*OPINION*

SWEET, J.

\*1 Defendants Ambassador Factors Corporation d/b/a Ambassador Factors, a division of Finova Capital Corporation ("Ambassador"), S. Roberts, Inc. ("S.Roberts"), Jay Vee, Inc. ("Jay Vee"), and Nathan Korman a/k/a Lawrence Korman ("Korman"), (collectively, "Defendants") have moved, pursuant to Rules 50 and 59, Fed.R.Civ.P., for judgment notwithstanding the verdict, a new trial, or remittitur of the damages awarded to plaintiff Robert Shamis ("Shamis"), as assignee of Wishbone Trading Company Limited ("Wishbone"). Shamis has moved for a declaration of nondischargeability of Korman's debt. For the reasons stated below, the motions are granted in part and denied in part.

*The Parties*

Plaintiff Shamis is a citizen of Israel and a British national, and at all times relevant to this action, was a shareholder, officer and director of Wishbone.

Shamis is Wishbone's assignee.

Wishbone was a Hong Kong-based apparel exporter that shipped goods primarily to the United States. In December 1993, Wishbone was placed in receivership and ultimately liquidated in accordance with Hong Kong law.

Defendant S. Roberts is a bankrupt New York-based wholesale distributor of women's dresses.

Defendant Jay Vee is a successor corporate entity of S. Roberts.

Defendant Korman was an officer and a 60% stockholder of S. Roberts.

Defendant Ambassador is a Rhode Island corporation that provides account receivable factoring services between importers and distributors in the garment industry.

Defendant Mahoney Cohen is a New York-based accounting company that performs private and public accounting, as well as related consulting and auditing services. [FN1]

FN1. Defendant Mahoney Cohen & Company, C.P.A., P.C. f/k/a Mahoney Cohen Rashba Pockart & Company, P.C. ("Mahoney Cohen") withdrew from this motion upon its post-trial settlement with Shamis.

*Prior Proceedings*

The prior proceedings of this action are set forth in the prior opinions of the Court, familiarity with which is assumed. *See Shamis v. Ambassador Factors Corp.*, 187 F.R.D. 148 (S.D.N.Y.1999); *Shamis v. Ambassador Factors Corp.*, 34 F.Supp.2d 879 (S.D.N.Y.1999); *Shamis v. Ambassador Factors Corp.*, No. 95 Civ. 9818, 1998 WL 75828 (S.D.N.Y. Feb.20, 1998); *Shamis v. Ambassador Factors Corp.*, No. 95 Civ. 9818, 1997 WL 473577 (S.D.N.Y. Aug.18, 1997); *Shamis v. Ambassador Factors Corp.*, No. 95 Civ. 9818, 1996 WL 457320 (S.D.N.Y. Aug.14, 1996). Proceedings relevant to the instant motions are set forth below.

The initial complaint in this action was filed on November 20, 1995. After several years of discovery and--as the citations in the previous paragraph

indicate--contentious motion practice, the case was tried to a jury over a three-week period beginning April 11, 2000. Six causes of action were submitted to the jury: common law fraud (as against S. Roberts, Korman, Ambassador, and Mahoney Cohen), breach of contract (as against S. Roberts and Ambassador), accounting malpractice (as against Mahoney Cohen), negligent misrepresentation (as against Mahoney Cohen), fraudulent conveyance (as against S. Roberts, Korman, and Jay Vee), and goods sold and delivered (as against S. Roberts). In addition, the jury was asked to make a determination as to whether Wishbone had received notice by November 29, 1994 of Korman's bankruptcy filing.

\*2 On May 1, 2000, the jury rendered its verdict, finding for Shamis on all counts. The special verdict form contained 33 questions and required the jury to make findings of fact with respect to each element of each cause of action. A copy of the special verdict form submitted to the jury is annexed hereto as appendix A.

Damages were awarded as follows: \$7.2 million on the common law fraud claim, with S. Roberts, Korman, Ambassador, and Mahoney Cohen each responsible for 25%; \$2 million on the breach of contract claim, with S. Roberts and Ambassador each responsible for 50%; \$3 million on the accounting malpractice claim against Mahoney Cohen; \$3 million on the negligent misrepresentation claim against Mahoney Cohen; \$2,656,551 on the fraudulent conveyance claim, with S. Roberts and Jay Vee responsible for 33% each, and Korman responsible for 34%; \$5.1 million on the goods sold and delivered claim against S. Roberts; and \$10 million in punitive damages, apportioned as follows: S. Roberts, 10%; Jay Vee, 10%, Korman, 10%, Mahoney Cohen, 35%, Ambassador, 35%.

The jury also found that Korman did not establish that Wishbone had notice of the filing of Korman's bankruptcy by November 29, 1994.

The Defendants moved for judgment as a matter of law at the close of Shamis's case and again at the close of all the evidence. The Court denied the motions, and the Defendants renewed their motions after the jury's verdict. A briefing schedule was set and the motions were deemed fully submitted after the Court heard oral argument on June 14, 2000.

#### *Facts*

The following facts, among others, were established

at trial.

This action centers around the alleged shenanigans of several players in New York's garment industry-- S. Roberts, Jay Vee, Korman, Ambassador, and Mahoney Cohen--which allegedly defrauded Wishbone, a Hong Kong-based trading company that financed S. Roberts's wholesale dress business from November 1989 until June 1991.

The New York players have known each other for some time. Arnold Cohen ("Cohen"), the president of Mahoney Cohen now as then (i.e., during the time period relevant to this action), has known Howard Rubin ("Rubin"), the president of Ambassador now as then, for twenty-five or thirty years. (Tr. 70- 73.) [FN2] Ambassador had factored [FN3] for El Jay, Jrs. ("El Jay"), a company controlled by Korman prior to the creation of S. Roberts, as a debtor in possession. El Jay's prior factor had told Ambassador that it believed El Jay had engaged in the unlawful invoicing practice of "prebilling," i.e., submitting sales invoices to the factor for payment when such sales had not in fact taken place. El Jay went bankrupt in 1986. In 1988, Korman asked Ambassador to be the factor for a start-up garment import company, S. Roberts.

FN2. References to trial exhibits are designated as "PX \_\_", "Amb. Ex. \_\_", "MC Ex. \_\_", and "SR Ex. \_\_". References to the trial transcript are designated as "Tr. \_\_". References to the exhibits attached to the affidavits, declarations, and appendices accompanying these motions are designated as "Storch Decl. Ex. \_\_" (decl. of Steven G. Storch dated June 9, 2000), "Good Aff. Ex. \_\_" (aff. of Douglas J. Good dated May 26, 2000) and "Olin Aff. Ex. \_\_" (aff. of Lane N. Olitt dated June 7, 2000).

FN3. A factor is a company that purchases accounts receivable from a wholesaler. "Factoring" is a form of financing that allows a wholesaler to obtain immediate payment for goods sold although the buyer is not obligated to pay for those goods until the conclusion of a credit period. When the wholesaler ships goods to a buyer, the factor pays the manufacturer the purchase price as shown on the invoice. *See Cofacredit, S.A. v. Windsor Plumbing Supply Co., Inc.*, 187 F.3d 229 (2d Cir.1999).

On or about August 26, 1988, Ambassador and S. Roberts entered into the Factoring Agreement. (Amb. Ex. HV; Good Aff. Ex. A.) The Factoring Agreement called for Ambassador to advance funds to S. Roberts against the collection of S. Roberts's receivables arising from bona fide sales, which were purchased by Ambassador. The Factoring Agreement prescribed that "[a]t the time of each sale [S. Roberts] shall execute and deliver to [Ambassador] a written assignment of the Receivables arising out of such sale, together with proof of delivery to [S. Roberts's] customer." (Id. at ¶ 2.) The proofs of delivery were meant to ensure that Ambassador only advanced money against actual sales.

\*3 For the first year of its factoring relationship with S. Roberts, Ambassador also financed the manufacture of goods sold by S. Roberts by posting letters of credit. (Tr. 563-564.) Thus, if S. Roberts defaulted in its payment obligations to Ambassador for the letters of credit, Ambassador's own funds and credit were at risk. (Id.)

Despite the terms of the Factoring Agreement, Ambassador did not in fact require S. Roberts to provide proofs of delivery with the assignment of each invoice in order to receive credit from Ambassador. (e.g. Tr. 571.)

During August, October, and November, 1989, S. Roberts's percentage of "chargebacks" [FN4] to sales net of returns exceeded 10%, an indication of potential problems with S. Roberts's business. At the same time, S. Roberts sought additional credit facilities from Ambassador, allegedly in order to expand its business. Ambassador declined to arrange or underwrite the additional credit facilities. (Tr. 565; Storch Decl. Ex. M (PX 513A).) S. Roberts then turned to Shamis, as representative of Wishbone. (Tr. 371-72; 797- 99 .) After reviewing S. Roberts's financial statement and making inquiries in the industry (Storch Decl. Ex. Q (PX 267)), Shamis agreed to extend credit to S. Roberts. (Tr. 799-800, 886-87.)

FN4. When the factor (e.g., Ambassador) seeks payment from a retailer for an invoice submitted by the wholesaler (e.g., S. Roberts), and the retailer refuses to make payment on the grounds that the goods were never shipped, or that the retailer did not order the goods, or similar grounds, the

money the factor had advanced to the wholesaler is "charged back" to the wholesaler.

On October 27, 1989, S. Roberts and Wishbone entered into a series of agreements: the Master Agreement (Good Aff. Ex. B (PX 217)), the General Security Agreement (Good Aff. Ex. C (PX 222)) and the Continuing Letter of Credit Agreement (Good Aff. Ex. D (PX 221)). The Master Agreement required that an Assignment of Factoring Proceeds Agreement ("AFP") be executed by S. Roberts, Wishbone, and Ambassador, which was accomplished on November 20, 1989 (Good Aff. Ex. E (PX 230)). In exchange for financing S. Roberts's inventory purchases by providing letters of credit, Wishbone received from S. Roberts, as collateral security for all sums due from S. Roberts, *inter alia*, a security interest in that inventory and all accounts receivable arising therefrom, as well as an assignment of up to 50% of the payments made by Ambassador to S. Roberts under the Factoring Agreement. (Good Aff. Ex. B (PX 217) at ¶¶ 3.1, 3.2.) The General Security Agreement gave Wishbone, *inter alia*, a security interest in all inventory sold or financed by Wishbone. (Good Aff. Ex. C (PX 222).) Under the Continuing Letter of Credit Agreement, S. Roberts agreed, *inter alia*, to indemnify Wishbone for any and all payment obligations Wishbone assumed to its banks for financing to S. Roberts (id.), and Wishbone's records were expressly designated *prima facie* evidence of the loan account between Wishbone and S. Roberts (id. at ¶ 5). Although the initial advance rate was 80%, the Factoring Agreement and AFP were subsequently amended, by letter dated July 10, 1990, to increase the advance rate to 85%, with 50% assigned to Wishbone and a balance due to S. Roberts of only 35%. (Good Aff. Ex. E (PX 558).)

\*4 There was no contact between Wishbone and Ambassador prior to Wishbone entering into the Master Agreement and the other agreements with S. Roberts.

As early as November 1, 1989, and prior to the AFP and any contact between Wishbone and Ambassador, Wishbone extended approximately \$10.5 million (U.S.) of financing to S. Roberts. (Good Aff. Ex. F (Amb.Ex. PF).)

Pursuant to the terms of the Agreements between Wishbone and S. Roberts, S. Roberts was required to furnish Wishbone with the following documents and

information, among others:

- ! Management or review financial statements, monthly. (Master Agreement ¶ 5(B); PX 217; Good Aff. Ex. B);
- ! Certified financial statements, annually. (Master Agreement ¶ 5(B));
- ! Statements of inventory position, bi-weekly. (Master Agreement ¶ 5(B));
- ! Recaps of credit approved orders, bi-weekly. (Master Agreement, ¶ 5(B));
- ! Monthly statements received from Ambassador, as available. (Master Agreement ¶ 5(C));
- ! Copies of all invoices assigned to Ambassador, simultaneous with the assignment thereof. (Master Agreement Schedule ¶ 14);
- ! Invoices, shipping documents, delivery receipts, purchase orders, contracts or other documents relating to its accounts receivable, on demand. (General Security Agreement ¶ 4(C); PX 222; Good Aff. Ex. C);
- ! Such other documents as Wishbone shall reasonably require. (Master Agreement ¶ 5(B).)

Wishbone received virtually none of this information or documentation, except for a few inventory reports (Tr. 1168-1172, 2045-2046; Good Aff. Ex. G), none of which was alleged to be inaccurate.

Pursuant to the terms of the AFP, Wishbone specifically acknowledged that Ambassador was entitled to reserve or to pay, from sums otherwise payable to S. Roberts and Wishbone, any amounts as might be due to Ambassador from S. Roberts. Wishbone also specifically recognized that: (i) Ambassador retained all of its rights under the Factoring Agreement with S. Roberts, including the right to make "chargebacks" for disputed invoices; and (ii) credit balances in S. Roberts's favor shown on account statements were provisional only and subject to such chargebacks. (Good Aff. Ex. E at 1 ¶ 3.) Wishbone also agreed that Ambassador retained full discretion to determine what amounts were payable at any time to S. Roberts under the Factoring Agreement. (Id.) Also pursuant to the AFP, Ambassador subordinated its prior security interest under the Factoring Agreement to Wishbone's security interest under the Master Agreement with respect to all inventory that Wishbone had supplied and/or financed. (Storch Decl. Ex. O (PX 230) at M000077, 78-79.) Consequently, Wishbone's security interest in the inventory it supplied or financed was superior to Ambassador's unless and until Ambassador paid Wishbone its portion of the factoring proceeds (id. at M000079), and even then, Ambassador's security interest became superior to

Wishbone's only if the funds were advanced against bona fide sales.

\*5 These agreements thus provided Wishbone with multiple security mechanisms, including: a first lien in all goods shipped and receivables arising therefrom; a subordinate lien if the goods were actually sold in return for an advance payment of between 40% and 50% of the factored receivables; and payment of the same percentage of the balance, or reserve, upon Ambassador's collection of the full amount from S. Roberts's customers. (*See* Storch Decl. Exs. U (PX 220), S (PX 221), O (PX 230), E (Amb.HV).)

Further, pursuant to the terms of the AFP, Wishbone had the right to request, from Ambassador, copies of all information and reports Ambassador delivered to S. Roberts. (Good Aff. Ex. E at 2 ¶ 2.)

At or about the time it entered into the Agreements with S. Roberts, Wishbone was a successful multi-national business, with offices in 22 countries, and was one of the largest privately-held trading companies in Hong Kong. (Good Aff. Ex. H (PX 343).) From an initial investment of \$5,000 in the 1970's (Tr. 1133- 1134; Good Aff. Ex. I), Shamis built Wishbone into a company with gross sales in excess of \$900 Million (HK) in fiscal year ending March 31, 1993. (Wishbone 1993 Draft Financial Statement, Good Aff. Ex. J (SR Ex. DD).) In addition, Wishbone and Shamis held ownership interests in various subsidiaries, affiliates and related companies. (*See, e.g.*, Wishbone Organizational Chart from the Receivers' Report dated Feb. 1, 1994, Good Aff. Ex. K (PX55).)

Ambassador did not inform Wishbone of the allegations of prebilling at El Jay, of the increase in the chargeback percentage rate for S. Roberts in August, October, and November, 1989, or of the fact that Ambassador was not receiving proofs of delivery from S. Roberts. At a meeting between Shamis and Rubin around the time when the AFP was signed, Rubin told Shamis that Ambassador did not want to finance S. Roberts itself because it was "too big a commitment," but that "it was a very good business" and "doing very well." (Tr. 814.) Shamis asked Rubin "to please take care of my money and he said he would." (Id.)

Korman and Rubin, and thereby S. Roberts and Ambassador, were aware that Wishbone was subject to a tight payment schedule on its bank loans and that Wishbone's ability to make payments on its own debt

depended in part on S. Roberts's fulfillment of its obligations under the agreements with Wishbone. (Tr. 311-12, 385, 618, 815-16, 845-46, 1704-05.)

In the Spring of 1990, S. Roberts's indebtedness to Wishbone peaked and it was behind in its repayment obligations. Wishbone was forced, as a result, to apply its own funds toward retirement of the debt incurred under the letters of credit opened for S. Roberts' benefit. (Tr. 846.) Also at this time, Wishbone made some efforts to obtain, but could not secure, timely and accurate financial information from S. Roberts. (Tr. 75-77, 86, 818-21; Storch Decl. Ex. V (PX 15).) Shamis spoke to Korman daily during this time, and "was chasing him for an inventory." (Tr. 819.) Shamis was not sure whether he had received inventories previously.

\*6 As S. Roberts, Korman and Ambassador were aware, for all but two months from November 1989 through August 1990, the percentage of chargebacks to sales net of returns was well above 10%, averaging 15.86% even taking those two months into account. (Storch Decl. Ex. M (PX 513A).)

Shamis, concerned about the accuracy of S. Roberts's books, introduced Korman to Marvin Weissman ("Weissman"), the managing partner of an accounting firm trusted by Shamis, early in 1990. Although Korman hired Weissman, they did not get along. Weissman, according to Shamis, "is a very, very religious Orthodox Jew and apparently wasn't used to hearing the type of language that came from Mr. Korman's mouth." (Tr. 820.) [FN5] The relationship between Korman and Weissman apparently ended rather quickly, because Weissman never provided Wishbone with an inventory of S. Roberts. (Tr. 819-20.) Shamis next introduced Korman to Cohen. Mahoney Cohen was then engaged to perform an audit of S. Roberts, with the knowledge that it was for Wishbone's use.

FN5. From various faxes between Shamis and Korman and other documentary evidence in this case, it appears that Shamis was capable of language every bit as colorful as Korman's. (*See, e.g.*, MC Ex. P (Novack Aff. Ex. F), ¶¶ 1, 8, 9.)

In the course of its investigation, Mahoney Cohen familiarized itself with the prior history and relationships between S. Roberts, Wishbone, and Ambassador set forth above.

On October 8, 1990, Mahoney Cohen discovered inventory still on hand in S. Roberts's warehouse for which S. Roberts had recorded \$5.1 million in sales over the period ending September 30, 1990, a practice termed "bill and hold," which suggested that the sales had never taken place. If these sales were eliminated from S. Roberts' financials, S. Roberts's bottom line would have been materially and adversely altered. According to Robert Berliner ("Berliner"), Shamis's accounting expert, Mahoney Cohen's work papers demonstrated that S. Roberts was engaging in prebilling, and furnishing invoices to Ambassador for goods neither sold nor shipped, for which Ambassador would make payments to S. Roberts and to Wishbone. Cohen testified, however, that S. Roberts did not supply invoices to Ambassador for payment on any of the \$5.1 million in inventory recorded on S. Roberts' books as "sold" until such inventory was in fact sold. (Tr. 106-07, 139.)

Also in October 1990, Dennis Yip ("Yip"), Wishbone's Chief Financial Officer, met with representatives of S. Roberts, Mahoney Cohen, and Ambassador in New York to understand why S. Roberts was approximately \$4.4 million behind in its payment obligations to Wishbone and to obtain a workable repayment plan. (Tr. 824-26; Storch Decl. Ex. AG (Yip Tr. 132-33).) In a meeting between Yip, Rubin, and a Mahoney Cohen representative that was not attended by anyone from S. Roberts, Rubin told Yip that S. Roberts's difficulties were due to the "seasonal factor of the dress business ." (Storch Decl. Ex. AG (Yip Tr. 20- 21).) Neither Rubin nor Mahoney Cohen mentioned the chargeback ratio in the S. Roberts account, or the inventory Mahoney Cohen had discovered which had been recorded as sold. During the same trip to New York that month, Yip negotiated a repayment plan (the "Yip Agreement") whereby Wishbone would continue to do business with S. Roberts. (Storch Decl. Ex. AK (PX 209).) The Yip Agreement, among other things, laid out S. Roberts's past-due obligations to Wishbone, trade receivables to be booked from October 1990 to June 1991, and a payment schedule to cover both S. Roberts's past-due debt and the obligations it would subsequently incur if the parties continued doing business. (Tr. 825-30; Storch Decl. Ex. AK (PX 209).) By his signature on the Yip Agreement, Korman expressly represented and warranted for S. Roberts that the figures contained therein were "most realistic and workable." (Id.).

\*7 Between Yip's meetings in New York in early

October 1990 and December 1990, Shamis inquired about the progress of the audit and sought Cohen's assurance that, based on his review of S. Roberts's financial records, the Yip Agreement truly represented a repayment plan that was workable. (Tr. 830.) Cohen assured Shamis that "he was comfortable [with] this repayment schedule, and he was comfortable with his progress on the audit" (Tr. 830), and did not mention the issue of possible prebilling (Tr. at 830; Storch Decl. Exs. Y, Z (PX 118, 119)). Berliner testified that proper accounting practice dictated that these concerns should have been disclosed to Shamis under these circumstances. (Tr. 1624.)

On the basis of these negotiations and conversations, Wishbone continued in business with S. Roberts and opened an additional \$10 million in credit facilities for S. Roberts's benefit through June 1991. (Tr. 830.)

Unbeknownst to Wishbone, Cohen and Korman met in late November 1990 to discuss the problems Cohen's staff accountants had uncovered and what to do about the audit. (Storch Decl. Ex. AN (PX 431A at entry for November 30, 1990); Tr. 113, 392-393.) Cohen testified that these problems were minor--delays of a few days in shipment. Yet the "sold" goods had been sitting in the warehouse for months. For instance, one \$385,000 invoice dated July 31 was not shipped until October 10, 1990 and 17 invoices dated in August were not shipped until November. (Storch Decl. Ex. AE (PX 511A at F1).) Berliner testified that based upon Mahoney Cohen's investigation, it could not issue an unqualified audited financial statement without alerting Wishbone to S. Roberts's pre-billing. (Tr. 393; Storch Decl. Ex. AE (PX 511A at 2-3).) The decision was made to perform a "review" in place of an audit. Shamis was not informed of the reasons for this decision. (*Compare* Tr. 1622-1624, 1651-1652 *with* Tr. 251-252.)

While Mahoney Cohen and S. Roberts signed an engagement letter on August 26, 1990, purporting to set forth, in advance, that the parties contemplated that the audit might be aborted and converted to a review, the letter not only made no sense in view of Berliner's testimony, but it is conspicuously dated in handwriting, as actually having been signed in November, 1990--the very period during which Cohen and Korman were meeting over what to do about the improprieties Cohen had found. Mr. Berliner offered un rebutted testimony that these deceptions on Mahoney Cohen's part with respect to the aborted audit engagement, among a host of

others, violated Generally Accepted Accounting Standards ("GAAS"), Generally Accepted Accounting Principles ("GAAP"), the Professional Code of Conduct, and the Statement on Auditing Standards ("SSARS") in numerous respects. (Storch Decl. Exs. AE (PX 511A at 3-4, 1-1--2-4, 4-1--5- 2), AF (PX 511B); *see generally* Tr. 1619-632, 1650-652.)

The review of S. Roberts's books and records as of December 31, 1990 (Tr. 113, 391-96), was performed under a less exacting standard than an audit (Tr. 1624). Cohen told Shamis that the change to the review format had to do with timing (*compare* Tr. 830, 831-32 and 1622-625 *with* Tr. 112-13 and 392), when the record reveals that Mahoney Cohen had ample time to complete, and there was no valid reason for not reporting on the audit engagement without violating SSARS, [FN6] (Tr. 1622-625, 1651-652). Instead, as Mr. Berliner confirmed at trial, Cohen subordinated his independent, professional judgment as an auditor to that of S. Roberts (Tr. 1622), and caused his firm to proceed with a review (Tr. 113).

FN6. As Mr. Berliner testified, the SSARS literature "indicates that the accountant is supposed to evaluate the client's reasons for a change in level of service. And if there are no valid reasons, then the accountant is supposed to complete the original engagement [and] report on it." (Tr. 1624.) Mr. Berliner's testimony left no room for doubt that the decision of Cohen and Korman to issue a financial statement based on a review instead of an audit constituted such a "change in the level of service," and that, in his uncontested, expert opinion "there were no valid reasons for not reporting on the audit engagement." (Id.)

\*8 During the course of that review, Mahoney Cohen's staff accountants discovered that inventory which had been booked as sold in 1990 was still in the warehouse as of early 1991, and further, that S. Roberts had not, as Cohen put it, "corrected" its practice of "pre-billing." (Tr. 117.) In spite of the recommendations of his staff accountants, Cohen, on Mahoney Cohen's behalf, rejected the adjustment recommended by his staff as required by generally accepted accounting principles to correct the inaccuracy (Tr. 120; Storch Decl. Ex. AD (PX 458 at M000677)), endorsing a financial statement for

presentation to Wishbone that falsely inflated S. Roberts's worth. As presented to Wishbone, that financial statement showed a small gross profit for S. Roberts when, by Cohen's own account, S. Roberts had suffered losses of at least a half million dollars (Tr. 247), and, in reality, as Wishbone's expert opined, the loss exceeded \$654,000. (Tr. 1631; Storch Decl. Ex. AF (PX 511B).)

In early January 1991, Mahoney Cohen's field accountants visited the New Jersey warehouse to determine whether S. Roberts was following their recommendation to segregate the goods recorded on S. Roberts's internal books as sales not assigned to the factor. During that visit, Mahoney Cohen's field accountants observed such inventory. (Tr. 117-18.)

By the first week of January, shortly after Mahoney Cohen's visit to the warehouse, virtually all of this inventory was, in fact, shipped to customers. (Tr. 123, 197-98.) Cohen testified that a cut-off date as of a few days after the end of a financial period is normal in the apparel industry, and that, consistent with this industry practice, S. Roberts itself had previously used a cut-off date a few days after the end of the financial period for the year ended December 31, 1989.

However, there were virtually no "purchasing customers." S. Roberts merely got the suspect inventory out of its warehouse within the first few weeks of the New Year, but the goods it shipped as a result, all of which were wrongfully recorded as sold in the previous year, were largely rejected or returned, only a few months later, by "buyers" who realized that S. Roberts had shipped them goods they had never ordered (Tr. 134, 399-401, 595-96), resulting in an explosion of chargebacks from Ambassador. (Tr. 134; Storch Decl. Ex. M (PX 513A).)

According to Shamis, he spoke to Cohen two or three times between January and March 1991 about how the audit was going. (Tr. 929.) Shamis admittedly understood that S. Roberts, not Wishbone, was Mahoney Cohen's client (Tr. 921- 22), and Shamis conceded that when he requested information from Cohen about S. Roberts, Cohen would tell him that he had to obtain permission first from S. Roberts. (Tr. 919-23.) Furthermore, while Shamis maintained that Mahoney Cohen knew that he refrained from foreclosing on inventory in reliance upon Mahoney Cohen's accountant's review report, Shamis admitted that, during the relevant period, he did *not* indicate to Cohen that he was considering foreclosing on S.

Roberts's inventory. (Tr.1941.)

\*9 While Wishbone pressed Mahoney Cohen for inventory aging reports on S. Roberts and the financial statement (*see, e.g.*, Storch Decl. Exs. AP, (PX 1), AQ (PX 421), U (PX 220)), Korman and Cohen formulated the plan to create Jay Vee. (Storch Decl. Exs. A (PX 206) ("So far everything is on plan"), AQ (PX 1), D (PX 216); *see* Tr. 172-75; Ex. X (PX 228 at M000008, 11, 13).)

By April 1991, Ambassador was well aware of unusually late payment patterns on the covered receivables from several of S. Roberts's retail customers which Ambassador knew were prompt payers and that such customers were claiming that they had not received or ordered the goods. (Tr. 571-572.) The disputes concerning those receivables had mounted to the millions (Tr. 134), and Ambassador knew that chargebacks to S. Roberts' account, stemming from the indiscriminate shipment of goods to cover the supposedly "sold" inventory on hand in the early weeks of the year, had reached an all time high, to that point, of 31.4%. (Tr. 134; Storch Decl. Ex. M (PX 513A).) [FN7] By the end of April 1991, with Cohen and Korman's "plan" to form Jay Vee well under way (*see* Storch Decl. Exs. A (PX 206); X (PX 228)), Rubin met with Cohen and told him that there had been millions of dollars of chargebacks to S. Roberts account because its customers claimed that they had not ordered the goods. (Storch Decl. Ex. AP (PX 1); Tr. 134, 399-400. *See also* Storch Decl. Exs. AR (PX 194), AS (PX 270), AT (PX 561), AM (PX 561A).) Neither Rubin nor Cohen disclosed any of these issues to Wishbone. (*See* Tr. 833-39.)

FN7. The percentage of chargebacks surged again in September of 1991 to four times the 10% that, by Rubin's own concession, was indicative of fraud and soared to "infinity" in 1992. (Tr. 691; Storch Decl. Ex. M (PX 513A).)

Rather, in late April or early May 1991, Cohen released the S. Roberts financial review statement to Wishbone with the proviso that it was intended for Shamis's use only. (Tr. 834; Storch Decl. Ex. AV (PX 412).) Ambassador advised Wishbone in the early part of 1991 that it would resume paying the original advance rate, due to difficulties in accounting for the payments to Wishbone at the higher rates. (Storch Decl. Ex. AW (PX 557).) It can be concluded, however, that because the disputes between S.

Roberts and Ambassador were skyrocketing into the millions, Ambassador was covering its own back. (Storch Decl. Ex. M, (PX 513A); Tr. 134, 399-400.)

After receiving and reviewing the financial statement Wishbone decided to wind down the business with S. Roberts (Storch Decl. Ex. AV (PX 412); Tr. 839), instead of simply foreclosing on the inventory, in order that it might live up to the commitments it had already made to S. Roberts and allow S. Roberts time to find alternative sources of financing (Tr. 839). Had Mr. Shamis known of S. Roberts's actual losses, he would have foreclosed instead, putting S. Roberts immediately out of business, but enabling Wishbone to recoup at least a portion of the outstanding debt. (Tr. 250, 839.) Evidence was presented indicating that Wishbone could have been made whole if it had foreclosed on S. Roberts instead of winding down. (See Amb. Opp. Mem. at 32 (charting trial exhibits).)

**\*10** By the end of June 1991, when Wishbone stopped shipping goods and opening new letters of credit for S. Roberts, Ambassador had learned that S. Roberts was going into liquidation and would not be buying any new merchandise from any source. (Tr. 597, 606.) Ambassador did not share this information with Wishbone. Cohen and Korman, on the other hand, told Shamis that S. Roberts would continue in business with a new supplier. (See Tr. 1052; PX 231.) Only unbeknownst to Wishbone, they continued S. Roberts's business as Jay Vee with the new supplier.(Tr. 601.) Then, on July 3, 1991, just two days after Jay Vee was officially formed, Korman, Cohen and Rubin met. (See Storch Decl. Exs. AZ, (PX 27); BA (PX 431B).)

At the time of that meeting, Ambassador "had an investment in the [S. Roberts'] receivables of a substantial amount of money," well into the millions of dollars, that had yet to be repaid. (Tr. 598-599.) Rubin knew that "Jay Vee was going to be taking over the [S. Roberts] name, the customers, essentially the entire business of S. Roberts" (Tr. 612), and Ambassador became Jay Vee's factor from the start, without conducting any financial investigation of Jay Vee (Tr. 608).

Ambassador and Cohen knew that Jay Vee needed Wishbone's consent to release its security interest in order for Jay Vee to take over the assets, customers and inventory of S. Roberts. (See Storch Decl. Exs. D (PX 216), AH (PX 96); Tr. 614-15, 862.) Yet Cohen and Ambassador implemented the Jay Vee plan despite the fact that Shamis did not agree to release its security interest in S. Roberts's inventory. (Storch

Decl. Ex. AH (PX 96) ("Bob does not agree").) Within two weeks of the July 3 meeting, Ambassador executed a factoring agreement with Jay Vee and began factoring for Jay Vee on S. Roberts's inventory and receivables-- property that belonged to Wishbone under the Agreements. (See Tr. 414-415; Storch Decl. Exs. AI (PX 104), AJ (PX 538).)

Meanwhile, Korman continued to negotiate a repayment plan with Shamis by phone. (Tr. at 841.) Korman suggested a payment schedule of \$500,000 per month plus interest, a figure that dropped to \$250,000 per month once Shamis arrived to finalize the plan with Korman and Cohen in person at the end of July. (Tr. 841-42.) After Shamis vented during "15 or 20 minutes of yelling," Cohen took Shamis aside and convinced him to accept the lower repayment plan because, as Cohen put it, insisting on \$500,000 a month would force S. Roberts out of business. (Tr. 842-843.) During this conversation, Cohen did not disclose the fact that S. Roberts had already effectively shut down and transformed its operations into Jay Vee. (Tr. 845.)

During the same time that Korman and Cohen were presenting projections to Wishbone showing S. Roberts as a viable business, they met with Rubin and presented him with a very different set of projections. (Tr. 604-605.) These figures showed that S. Roberts was declining into liquidation, while Jay Vee gained as it took over the S. Roberts business. (Tr. 605-607.)

**\*11** By the end of 1991, S. Roberts had defaulted on the repayment plan Cohen had talked Wishbone into accepting. [FN8] Wishbone had promised to repay the banks financing it based on S. Roberts's repayment commitment, and Wishbone came under increasing pressure from the banks as S. Roberts failed to meet its obligation. (Tr. 850 .) In early 1992, Wishbone demanded written confirmation from S. Roberts and Ambassador of the status of the S. Roberts account. On April 6, 1992, S. Roberts responded, with Ambassador's express written approval, that there was "approximately a USA \$2.0 million credit balance" in S. Roberts's account with Ambassador and that, "as at this date we are not aware of any material adverse changes to the above stated accounts." (Storch Decl. Ex. BC (MC-D).) However, other information that was not disclosed to Wishbone belied these assertions. (See Storch Decl. Ex. M (PX 513A) (showing more than \$1.4 million in chargebacks against virtually no sales from April through November 1992).)

FN8. Nonetheless, S. Roberts had "loaned" Korman \$776,000 during that year. (Storch Decl. Ex. I (PX 37).)

In reliance on the April 6 letter from Ambassador and S. Roberts, Wishbone promised its bank that it could expect to receive \$4.6 million by July to pay down the outstanding debt incurred on the S. Roberts account. (Tr.2026-27; Storch Decl. Ex. BI (Amb.Ex. L).) However, because S. Roberts repaid only about \$1 million to Wishbone through July 1992 (Good Aff Ex. N; Tr.2027), Wishbone was unable to fulfill its promise to the banks. Wishbone lost significant credibility with its bankers because, as Shamis testified, Wishbone's promises to repay simply "weren't coming true." (Tr. 850.) The banks reduced and then terminated Wishbone's "life blood" (Tr. 795-795), its line of credit (Tr. 284, 1238-39, 1687-88, 1704, 2028). Officers at two banks, Phillippe Rafat, formerly of Credit Commercial de France (CCF) in Hong Kong, and Nicholas Jewitt, formerly of BankBoston, testified that the S. Roberts receivable was the primary factor in their banks' cutting back on Wishbone's credit. (Tr. 278-85, 1707.) As stated above, Wishbone was entirely liquidated in December of 1993.

### *Discussion*

#### *I. Korman's Debt Is Not Dischargeable*

Korman asserted as his Second Affirmative Defense that any claims asserted against him by Wishbone were discharged by the United States Bankruptcy Court for the District of New Jersey (the "Bankruptcy Court"). (See Olitt Aff. Ex. A ¶ 149.) As reflected in the trial record and in plaintiff's trial exhibit 114 (see Storch Decl. Ex. B), on or about August 29, 1994, Korman filed with the Bankruptcy Court and pursuant to Chapter 7 of the U.S. Bankruptcy Code, a Voluntary Petition, seeking a discharge of debts (the "Bankruptcy Petition"). As reflected in "Schedule E" of the Bankruptcy Petition, Korman scheduled therein a disputed claim of Wishbone Trading Co, 14F Tower II Silvercord, 30 Canton Road, Tsimshatsu Kowloon, Hong Kong. (Storch Decl. Ex. B.) Thereafter, the Clerk of the Bankruptcy Court mailed scheduled creditors a Notice of Commencement of Case under Chapter 7 of the Bankruptcy Code, Meeting of Creditors and Fixing of Dates (Individual or Joint Debtor No Asset Case), dated September 9, 1994. (See Olitt Aff. Ex. B (the "Bankruptcy Notice").) Creditors were notified that

they were not to file a proof of claim, as Korman's bankruptcy was a "no asset case." Creditors were further notified that November 29, 1994 was the "Deadline to File a Complaint Objecting to Discharge of the Debtor or to Determine Dischargeability of Certain Types of Debts." (Olitt Aff. Ex. B.)

\*12 By Discharge of Debtor, filed on December 15, 1994 (the "Discharge Order"), the Bankruptcy Court discharged Korman from all dischargeable debts. (Storch Decl. Ex. E.) The debt alleged by Shamis to be owed by Korman arose prior to the commencement of Korman's Chapter 7 Bankruptcy Proceeding. Korman filed a motion *in limine* seeking, in part, to preclude Shamis from proceeding to trial against Korman, based on the Discharge Order. Due to the late hour of the motion and the relative complexity of the legal issues involved, the Court held any decision on that application in abeyance, and allowed the trial to proceed against Korman. As the motion *in limine* set forth, correspondence was exchanged between counsel years before the trial, wherein Korman's counsel requested that Shamis discontinue the action against Korman based on the Discharge Order. Shamis's counsel responded that Wishbone never received notice of Korman's bankruptcy, and that unless Korman agreed to have the claim against him transferred to the Bankruptcy Court, Shamis would file a motion challenging the discharge of Wishbone's claim (assigned to Shamis well after entry of the Discharge Order). Shamis did not file such a motion over the course of the years that followed or prior to trial, and now, as directed by the Court, seeks a declaration of nondischargeability.

As set forth previously with regard to Korman's bankruptcy, the Jury answered "No" to the question "Has Korman established that Wishbone had notice of the filing of Korman's bankruptcy by November 29, 1994?" As to the ultimate determination on the question of dischargeability, the Court stated to the parties that that determination would be made by the Court rather than the jury.

Absent a declaration from the bankruptcy court or this Court that Korman's debt to Wishbone was excepted from discharge, any judgment against Korman in this action would be subsumed by Korman's Chapter 7 filing in 1994.

Section 523 of the Bankruptcy Code, codified at 11 U.S.C. § 523, governs exceptions to discharge. Under § 523(a)(3), a discharge will not release an individual from debt that is:

neither listed nor scheduled ... with the name, if

known to the debtor, of the creditor to whom such debt is owed, in time to permit--

...

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request.

Subparagraph (a)(2) of § 523 includes debts:

for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--

(A) false pretenses, a false representation, or actual fraud ... [or]

(B) use of a statement in writing--

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

\*13 (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive....

11 U.S.C. § 523(a)(2).

This Court has concurrent jurisdiction with the bankruptcy court to determine dischargeability pursuant to 11 U.S.C. § 523(a)(3). *See In re Massa*, 217 B.R. 412, 420 (Bankr.W.D.N.Y.1998), *aff'd* 187 F.3d 292 (2d Cir.1999); *In re Szczepanik*, 146 B.R. 905, 913 (Bankr.E.D.N.Y.1992); *Zachary v. Whalen*, 1994 WL 411526,\*5, 65 Fair Empl. Prac. Cas. (BNA) 935 (N.D.N.Y.1994).

Shamis carries the burden of establishing by a preponderance of the evidence that Wishbone has a § 523(a)(2) claim. *See In re Szczepanik*, 146 B.R. at 914; *Zachary v. Whalen*, 1994 WL 411526,\*6. "[A]n exception to a debt's discharge should be strictly construed because of the policy of favoring a debtor's fresh start." *Zohlman v. Zoldan*, 226 B.R. 767, 777 (S.D.N.Y.1998) (citing cases).

Korman maintains, first, that a debt is excepted from discharge under § 523(a)(2) only if the debtor derives actual benefit for himself by use of the false representations. For this proposition, Korman cites *In re Rubenstein*, 101 B.R. 769 (Bankr.M.D.Fla.1989), as well as *In re Gans*, 75 B.R. 474, 483 (Bankr.S.D.N.Y.1987), *In re Auricchio*, 196 B.R. 279 (Bankr.D.N.J.1996), and *In re Duncan*, 162 B.R. 905 (Bankr.M.D.Fla.1993). He contends that a viable claim that a debt is nondischargeable cannot be

sustained where the debtor never individually received any money, property, services, or extension, renewal, or refinancing of credit from the creditor.

The court in *Rubenstein* acknowledges, however, that "there are a line of cases which hold that it is not necessary that property be actually procured for the debtor himself." *In re Rubenstein*, 101 B.R. at 772 (citing *In re Kunkle*, 40 F.2d 563 (E.D.Mich.1930); *Speir v. Westmoreland*, 40 Ga.App. 302, 149 S.E. 422 (Ga.App.1929); *In re Scheffler*, 1 F.Supp. 582 (N.D.N.Y.1932); *In re Nowell*, 29 B.R. 59 (Bankr.N.D.Miss.1982)). Moreover, as the *Auricchio* court noted,

This issue has not been settled under bankruptcy law. Some courts have held that it is not necessary that the property be received by the debtor for Code section 523(a)(2) to apply. *In re Ashley*, 903 F.2d 599, 604 n. 4 (9th Cir.1990); *In re Carroll*, 16 B.R. 494 (D.Minn.1982); *In re Mann*, 40 B.R. 496, 499 (Bankr.D.Mass.1984); *In re Winfree*, 34 B.R. 879, 882-83 (Bankr.M.D.Tenn.1983). Other courts, however, have determined that in order for the exception to discharge to apply the property must be received by the debtor. *See In re Rippey*, 21 B.R. 954 (Bankr.N.D.Tex.1982) (finding that " § 17a(2) exception to discharge of a debt is inapplicable where the bankrupt obtained no property for himself ..."). According to one commentator, however, "[t]he better view seems to be that it is not necessary that the property be actually procured for the debtor" for section 523(a)(2)(A) to apply. 3 Collier on Bankruptcy ¶ 523.08, at 523-51 (15 ed.1994).

\*14 *In re Auricchio*, 196 B.R. at 286.

While the Court is inclined to agree with Collier that it is unnecessary for the property to be received by the debtor in order to qualify for an exception to discharge under § 523(a)(2), it is not necessary to decide the issue. Sufficient evidence was introduced at trial of personal benefits obtained by Korman as a result of his conduct with respect to S. Roberts and Jay Vee. For example, there is evidence that Korman siphoned over \$900,000 from S. Roberts in 1990 and 1991 (Storch Decl. Exs. H, I (PX 36, 37)), and then was discharged from his obligations on the loans from S. Roberts in bankruptcy (*see* Storch Decl. Ex. J (PX 114) at Sch. F.). "When a debtor has engaged in unwholesome conduct, he becomes ineligible for entitlement to the 'fresh start' desideratum" provided for in the Bankruptcy Code. *See In re Tobman*, 96 B.R. 429, 430, 439 (Bankr.S.D.N.Y.1989) (citations omitted), *rev'd on other grounds*, 107 B.R. 20 (S.D.N.Y.1989). As such, Korman's debt to

Wishbone is nondischargeable and subject to judgment in this case.

## II. Defendants' Post-Trial Motions

### A. Legal Standard

Pursuant to Rule 50, Fed.R.Civ.P., a party that has made a motion for judgment as a matter of law at trial may renew that motion after the jury returns a verdict. *See Braun Inc. v. Optiva Corp.*, No. 98 Civ. 4070(RCC), 2000 WL 223840, at \*1 (S.D.N.Y. Feb. 25, 2000). The standard for post-verdict judgment as a matter of law is analogous to the standard applicable to a judgment at the close of the opposition's case. *See Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 696, 82 S.Ct. 1404, 8 L.Ed.2d 777 (1962); *Diebold v. Moore McCormack Bulk Transport Lines, Inc.*, 805 F.2d 55, 57 (2d Cir.1986). Explaining the standard, the Court of Appeals has stated that the guiding principle is whether:

viewed in the light most favorable to the non-moving party, the evidence is such that, without weighing the credibility of the witnesses or otherwise considering the weight of the evidence, there can be but one conclusion as to the verdict that reasonable men could have reached.

*Sir Speedy, Inc. v. L & P Graphics, Inc.*, 957 F.2d 1033, 1038-39 (2d Cir.1992) (citations and internal quotations omitted). A motion for judgment as a matter of law may therefore be granted only where either: (1) there is such a complete absence of evidence supporting the verdict that the jury's finding could only have been the result of sheer surmise and conjecture; or (2) there is such an overwhelming amount of evidence in favor of the movant that reasonable and fair minded persons could not arrive at a verdict against it. *Braun*, 2000 WL 223840, at \*1 (citing *Samuels v. Air Transport Local 504*, 992 F.2d 12, 14 (2d Cir.1993); *Alvarez v. Abreau*, 54 F.Supp.2d 335, 344 (S.D.N.Y.1999)). In considering whether a defendant is entitled to judgment as a matter of law, a court must consider all of the evidence in the light most favorable to the nonmovant, and cannot substitute its own judgment for that of the jury, which itself has already had an opportunity to pass upon the credibility of witnesses and weigh conflicting evidence. *See Ortho Diagnostic Sys., Inc. v. Miles, Inc.*, 865 F.Supp. 1073, 1078 (S.D.N.Y.1994), *appeal dismissed*, 48 F.3d 1237 (Fed.Cir.1995).

\*15 Rule 59, Fed.R.Civ.P., permits the granting of a new trial after an earlier trial by jury, and the decision

whether to grant a new trial is "committed to the sound discretion of the trial judge." *Metromedia Co. v. Fugazy*, 983 F.2d 350, 363 (2d Cir.1992). A motion for a new trial may be joined with a motion for judgment as a matter of law.

A trial judge reviewing a jury verdict and judgment pursuant to a motion for a new trial has greater judicial discretion to grant such a motion than a motion for judgment as a matter of law. *See Montgomery Ward & Co. v. Duncan*, 311 U.S. 243, 251-52, 61 S.Ct. 189, 85 L.Ed. 147 (1940); *Bevevino v. M.S. Saydjari*, 574 F.2d 676, 683-84 (2d Cir.1978). Where the court is convinced that the jury has reached a seriously erroneous result or that the verdict is against the weight of the evidence, rendering any enforcement of its verdict a miscarriage of justice, the court may order a new trial. *See Mallis v. Bankers Trust Co.*, 717 F.2d 683, 691 (2d Cir.1983); *Purnell v. Lord*, 952 F.2d 679, 686 (2d Cir.1992).

This being said, a trial court should not set aside a jury verdict merely because of its disagreement with the jury's resolution of credibility issues, or because the jury's findings were at some variance with the court's. *See Braun*, 2000 WL 223840, at \*1; *Leotis v. City of New York*, 818 F.Supp. 63, 68 (S.D.N.Y.1993). A new trial should only be granted where the jury's verdict was "seriously erroneous," *Piesco v. Koch*, 12 F.3d 332, 345 (2d Cir.1993), or where the verdict constitutes a "miscarriage of justice." *Purnell*, 952 F.2d at 686 (citations omitted).

If a district court finds that a verdict is excessive, it may order a new trial, order a new trial limited to damages, or, under the practice of remittitur, condition denial of a motion for a new trial on the plaintiff's accepting damages in a reduced amount. However, it is not among the powers of the trial court, where the jury has awarded excessive damages, simply to reduce the damages without offering the prevailing party the option of a new trial. *See Tingley Systems, Inc. v. Norse Systems, Inc.*, 49 F.3d 93, 96 (2d Cir.1995); *Phelan v. Local 305*, 973 F.2d 1050, 1064 (2d Cir.1992).

B.S. Roberts, Korman and Ambassador Are Granted Judgment as a Matter of Law on the Common Law Fraud Claim

Under New York law, to prevail on a fraud claim a plaintiff is required to prove: "(1) a material false representation or omission of an existing fact, (2) made with knowledge of its falsity, (3) with an intent

to defraud, and (4) reasonable reliance, (5) that damages plaintiff." *Schlaifer Nance & Company, Inc. v. Estate of Warhol*, 927 F.Supp. 650, 660 (S.D.N.Y.1996), *aff'd* 119 F.3d 91 (2d Cir.1997) (citing *Diduck v. Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 276 (2d Cir.1992)). "[E]ach element of a fraud claim must be shown by clear and convincing evidence." *Banque Arabe et Internationale D'Investissement v. Maryland Nat'l Bank*, 57 F.3d 146, 153 (2d Cir.1995).

**\*16** To establish reasonable reliance, a plaintiff must show both that he "actually relied on the purported fraudulent statements or omissions and that [his] reliance was reasonable or justifiable." *Schlaifer Nance*, 927 F.Supp. at 660. See *Banque Arabe*, 57 F.3d at 156; *Harris v. Camilleri*, 77 A.D.2d 861, 431 N.Y.S.2d 65 (2d Dep't.1980).

Reliance on fraudulent representations or omissions is not reasonable or justifiable where a plaintiff is a "sophisticated business[man] engaged in major transactions, with access to critical information but fail[s] to take advantage of that access." *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 737 (2d Cir.1984); accord *Schlaifer Nance*, 119 F.3d at 101. Indeed, reliance on purported fraudulent representations or omissions is not reasonable or justifiable if the party "has the means of knowing, by the exercise of ordinary intelligence, the truth ... of the representation" and fails to "make use of those means". *Grumman*, 748 F.2d at 739 n. 13.

Wishbone was entitled to obtain a plethora of information directly from S. Roberts (Tr. 1150-1151, 1168-1172; Good Aff. Exs. G, Q), including information which, if obtained, would have revealed the true state of S. Roberts's financial condition. For example, the Master Agreement imposed upon S. Roberts the obligation file financing statements, supply biweekly inventory statements, and provide updates on credit approved orders, all "as and when required by Wishbone." (Good Aff. Ex. B ¶¶ 5(A), (B).) The General Security Agreement also provided that S. Roberts would provide financial statements and allow Wishbone to inspect collateral and audit S. Roberts's books, all at Wishbone's request. (Good Aff. Ex. C ¶ 4.) The AFP obliged Ambassador to provide copies of all information and reports at Wishbone's request, and contained a provision in which Wishbone specifically agreed that it could rely on information Ambassador provided only "at its own risk." (Good Aff. Ex. E at M000078 ¶ 2.)

As Shamis admitted in his testimony, Wishbone

never requested proofs of delivery from S. Roberts or other information to which Wishbone was entitled, did not get such information (Tr. 1168-1172, 2045-2046; Good Aff. Ex. G), and deliberately proceeded in its dealings with S. Roberts despite the fact that S. Roberts failed to provide such information (Tr. 1168-1169; Good Aff. Ex. G). As a matter of law, considering the evidence in the light most favorable to the plaintiff, Shamis did not establish the requisite reliance to support the jury's finding of common law fraud. Cf. *Cofacredit*, 187 F.3d at 241 (upholding a finding of reasonable reliance in false invoices case where "a routine financial investigation would not have revealed the true nature of the misrepresentations, which was not dependent on the Defendants' financial health ... [and because Plaintiff] did take reasonable precautions to protect itself from fraud.").

**\*17** There is such an absence of evidence proving that Wishbone reasonably relied on the representations and omissions of the defendants that the jury's contrary finding could only have been the product of conjecture. Notwithstanding the verdict, the common law fraud claims are therefore dismissed as against S. Roberts, Korman and Ambassador.

*C. The Breach of Contract Judgment Against S. Roberts and Ambassador Is Upheld* [FN9]

FN9. S. Roberts does not here contest the jury's finding that S. Roberts breached its contract.

#### 1. Breach of Express Promise

Under New York law, to prevail on a breach of contract claim a plaintiff is required to prove by a preponderance of the evidence that an agreement between plaintiff and defendants existed, and that while plaintiff performed its obligation, defendants committed an act in violation of the agreement. See *Agency Rent A Car Sys., Inc. v. Grand Rent A Car Corp.*, 98 F.3d 25, 31 (2d Cir.1996); *Coastal Aviation, Inc. v. Commander Aircraft Co.*, 937 F.Supp. 1051 (S.D.N.Y.1996).

A jury could reasonably conclude that the Master Agreement required S. Roberts to submit proofs of delivery to Wishbone, and that S. Roberts's undisputed failure to do so constituted an act in violation of the contract. The Master Agreement specifically provides that "Roberts shall supply

Wishbone with monthly management or review financial statements ... [and] Roberts shall, at two (2) week intervals, supply Wishbone with statements showing Roberts' inventory position ad a recap of credit approved orders." (Good Aff. Ex. B at ¶ 5 (B).) As stated above, S. Roberts falsified its billing statements and failed to provide bona fide proofs of delivery.

A rational jury could further reasonably conclude that S. Roberts was bound by the Master Agreement, the AFP, and the Security Agreement not to allow its inventory to be factored through Jay Vee in such a way as to defeat Wishbone's "first and prior security interest," (*see* Good Aff. Ex. E at M000079). The Master Agreement specifically provides that:

In the event of any default by Roberts under or in respect of or arising out of any obligation contained in this Master Agreement which default ... is not cured within 14 days ... of written notice of such default being given to Roberts by Wishbone, Wishbone shall have the irrevocable right to sell ... merchandise ordered but not delivered or paid for under all or any of the trademarks, patents or other intellectual property rights of Roberts.... The net proceeds of such sale(s) shall be credited to any liability of Roberts hereunder as Wishbone may decide, any surplus being transferred to Roberts.

(Good Aff. Ex. B at ¶ 6(C)). The Security Agreement defines default as occurring upon "nonpayment when due ... of principal of or interest on any Indebtedness." (Good Aff. Ex. C at ¶ 8(a).) Furthermore, the AFP provides that:

The Debtor [S. Roberts] does hereby understand, agree, warrant and represent to Assignee [Wishbone] that, *unless consented to in writing by Assignee*, it will not take any full or partial advance, draw-down, or anticipated payment against any credit balance or money due or to become due to it except to the extent of its remaining interest from the Factor [Ambassador] under the Factoring Agreement; that *it will not direct the Factor to make any payment or remittance to any third party*, other than Assignee, and to charge same to any credit balance or money due or to become due to Debtor from the Factor under the Factoring Agreement except with respect to monies due to other clients of the Factor or Debtor's remaining interest therein....

\*18 (Good Aff. Ex. E at M000078 ¶ 3) (emphasis added.) The Security Agreement granted Wishbone a first and prior security interest in all of S. Roberts's "inventory" and "proceeds" as collateral, and specifically covenanted that S. Roberts "will not sell,

transfer, lease, assign, deliver or otherwise dispose of any collateral or any interest therein without the prior written consent" of Wishbone. (Good Aff. Ex. C ¶ ¶ 1, 4.)

Furthermore, a jury could reasonably find that Ambassador was bound under the AFP to pay Wishbone a percentage of all monies due for the factoring of S. Roberts inventory. The AFP directed Ambassador "to pay to [Wishbone], and [Ambassador] agrees to pay [Wishbone], up to 50% of such sums as [Ambassador], in its sole discretion determines to be payable to [S. Roberts] from time to time pursuant to the Factoring Agreement...." (Good Aff. Ex. Ep. 1 ¶ 4.) Although the AFP gives Ambassador "discretion" to determine the specific percentage owed to Wishbone, the contract was clearly formed to provide Wishbone with "collateral security" for the debt it was owed from S. Roberts. A reasonable jury could conclude that, in the context of the ongoing relationship between these parties, Ambassador's "discretion" did not include the power to pay *no* percentage to Wishbone for the factoring of S. Roberts inventory through Jay Vee.

By transferring its inventory to its alter ego, Jay Vee, for factoring through Ambassador, S. Roberts violated its specific promise not to transfer collateral without Wishbone's prior written consent, and Ambassador violated its promise to to pay Wishbone a percentage of sums payable to S. Roberts. The transfer also violated S. Roberts's promise that Wishbone would have the right to sell such inventory in the event that S. Roberts failed to pay back its debt as well as its promise not to direct its factor to pay any third party.

In sum, a reasonable jury could easily conclude that S. Roberts's failure to provide bona fide proofs of delivery and the act of transferring its inventory to Jay Vee constituted a breach of S. Roberts's express contractual promises, and that Ambassador's factoring of S. Roberts inventory through Jay Vee without remitting a percentage to Wishbone was a breach of its contract with Wishbone. The \$2 million breach of contract verdict against S. Roberts and Ambassador stands.

## *2. Breach of Implied Covenant of Good Faith and Fair Dealing*

Even absent the breach of these express contractual provisions, S. Roberts and Ambassador would still be found liable for breaching the implied covenant of good faith and fair dealing that exists in every

contract under New York law. See *Van Gemert v. Boeing Co.*, 553 F.2d 812, 815 (2d Cir.1977); *Bissell v. Merrill Lynch & Co., Inc.*, 937 F.Supp. 237, 247 (S.D.N.Y.1996); *Rowe v. Great Atl. & Pac. Tea Co.*, 46 N.Y.2d 62, 68, 412 N.Y.S.2d 827, 830, 385 N.E.2d 566, 569 (1978). The implied covenant "ensures that parties to a contract perform the substantive bargained-for terms of their agreement." *Geren v. Quantum Chem. Corp.*, 832 F.Supp. 728, 732 (S.D.N.Y.1993) (quoting *Metropolitan Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F.Supp. 1504, 1517 (S.D.N.Y.1989)). A party's acts may infringe on the implied covenant of good faith when the party "acts so directly to impair the value of the contract for another party that it may be assumed that they are inconsistent with the intent of the parties." *Bank of China v. Chan*, 937 F.2d 780, 789 (2d Cir.1991). "[N]either party to a contract shall do anything that has the effect of destroying or injuring the right of the other party to receive the fruits of the contract," or to violate the party's presumed or reasonable expectations. *M/A-COM Security Corp. v. Galesi*, 904 F.2d 134, 136 (2d Cir.1990).

**\*19** The implied covenant of good faith and fair dealing, however, "arises only out of the known reasonable expectations of the other party which arise out of the agreement entered into. The covenant does not create duties which are not fairly inferable from the express terms of that contract." *Interallianz Bank AG v. Nycal Corp.*, No. 93 Civ. 5024, 1994 WL 177745 (S.D.N.Y.1994), at \*8 (citing *Fasolino Foods Co. v. Banca Nazionale del Lavoro*, 961 F.2d 1052, 1056 (2d Cir.1992)).

Wishbone's fundamental purpose in entering into the AFP was to secure payment of the debts that S. Roberts had already incurred or would later incur to Wishbone under the Master Agreement. The AFP was explicitly "cumulative to" the Factoring Agreement, which provided that Ambassador would purchase receivables based on S. Roberts's express representation and "proof" that "each Receivable is based upon [a] bona fide sale and actual delivery." (Good Aff. Exs. E at M000078 ¶ 3, A at ¶ ¶ 2, 6.) Wishbone's expectation that Ambassador would disclose material information regarding adverse influences on Wishbone's security interest was readily inferable from both the face of the AFP itself and from the nature of the ongoing relationship between the three parties.

Therefore, Wishbone's expectation was reasonable and may appropriately be construed as one of the benefits Wishbone bargained for in the contract. By

failing to disclose information it knew regarding S. Roberts's prebilling practices and mounting chargeback levels, and by surreptitiously factoring S. Roberts inventory through Jay Vee, Ambassador deprived Wishbone of the opportunity to receive the fruits of the Factoring Agreement. See *M/A-COM Security Corp.*, 904 F.2d at 136; *Pittsburgh Terminal Corp. v. Baltimore & Ohio Railroad Co.*, 680 F.2d 933, 941 (3d Cir.1982).

The jury had ample support for its judgment in favor of Shamis on the breach of contract claim. Ambassador's motion for judgment notwithstanding the verdict or for retrial on the breach of contract claim is therefore denied.

#### D. *The Fraudulent Conveyance Judgment Against S. Roberts, Jay Vee and Korman Is Upheld*

New York's Fraudulent Conveyance Act provides that to prevail on a claim of fraudulent conveyance, a plaintiff must prove by clear and convincing evidence that a transfer or conveyance was made with actual intent to hinder, delay or defraud any then present or future creditors. N.Y. Debt. & Cred. L. § 276 (McKinney 1990). See *United States v. McCombs*, 30 F.3d 310, 327 (2d Cir.1994); *Stochastic Decisions, Inc. v. DiDomenico*, 995 F.2d 1158, 1172 (2d Cir.1993).

As direct evidence of actual fraudulent intent is often hard to come by, "the fraudulent nature of a conveyance may also be inferred from the circumstances surrounding the transaction." *Manshul Construction Corp. v. Schulman*, 2000 WL 1228866,\*48 (S.D.N.Y.) (citing *In re Grand Jury Subpoena Duces Tecum Dated Sept. 15, 1983*, 731 F.2d 1032, 1041 (2d Cir.1984)). See *Dixie Yarns, Inc. v. Forman*, 906 F.Supp. 929 (S.D.N.Y.1995). Courts have identified several "badges of fraud" that cumulatively establish circumstantial evidence of intent to defraud, including the following:

**\*20** ! the close relationship among the parties to the transaction;

! the transferor's (and transferee's) knowledge of the creditor's claims or claims likely to be asserted, and the transferor's inability to pay them;

! the retention of control and economic and other benefits of the property by the transferor after the conveyance;

! the transferor's (and transferee's) financial condition before and after the transfer.

*SIPC v. Stratton Oakmont, Inc.*, 234 B.R. 293, 315, 318 (Bankr.S.D.N.Y.1999). See *Salomon v. Kaiser (In re Kaiser)*, 722 F.2d 1574, 1582-83 (2d

Cir.1983); *Le Cafe Creme, Ltd. v. Xavier Le Roux, et al.* (*In re Le Cafe Creme, Ltd.*), 244 B.R. 221, 242-43 (Bankr.S.D.N.Y.2000).

### 1. S. Roberts

There are sufficient "badges of fraud" to support a finding that S. Roberts had an actual intent to defraud Wishbone. It is undisputed that S. Roberts transferred all of its assets to Jay Vee in July of 1991, as soon as Wishbone refused to ship any more goods to S. Roberts. [FN10] The "close relationship" between S. Roberts and Jay Vee was obvious: key players at S. Roberts took up identical positions at Jay Vee, including Korman, the president, Gerald Werbin, the controller, and Vincent Caccese, who handled shipping and dealt directly with Ambassador. (*See, e.g.*, Storch Decl. Exs. AI, AP, AS; Tr. 603-605.) Furthermore, defendants concede that Jay Vee operated out of the "same premises" as S. Roberts and "retained control and economic benefits" of S. Roberts's property by selling its inventory. (Defs. Mem. for Judgment as a Matter of Law at 18.) As president of both transferor, S. Roberts, and of transferee, Jay Vee, Korman had "knowledge" of Wishbone's security interest in S. Roberts inventory and S. Roberts's inability to pay its debt. The trial evidence proved that Jay Vee was formed for the purpose of "taking over the name, the customers, essentially the entire business of S. Roberts." (Tr. 612-13; Storch Decl. Ex. AI (PX 104).) This purpose inescapably involved depriving Wishbone of its interest in S. Roberts's assets.

FN10. Although Wishbone did intend to wind down its business with S. Roberts as of June 1991 (Storch Decl. Ex. AV (PX 412); Tr. 839), it chose that course rather than foreclosure in order to allow S. Roberts to find alternative financing sources to remain in business. (Tr. 839.) If Wishbone had known the true extent of S. Roberts's losses it would have foreclosed in order to recoup its outstanding debt. (Tr. 250, 839.)

### 2. Korman

The badges of fraud discussed above equally indicate Korman's liability on the fraudulent conveyance claim. The trial evidence proved that Korman was a "beneficiary" of the transfer of assets to Jay Vee, both as the president of the new company, and as a personal beneficiary of hundreds

of thousands of dollars in "loans" from Jay Vee that were subsequently forgiven in Korman's own bankruptcy. (*See* Storch Decl. Exs. H-J (PX 37-38, 114) at Schedule F.)

Korman objects to the imposition of a judgment against him for fraudulent conveyance on the grounds that the complaint did not name him as a defendant on this claim. The danger in such a situation is that the failure to name him as a defendant would prejudice Korman by depriving him of the opportunity to defend against it. *See, e.g.*, *Hillburn by Hillburn v. Maher*, 795 F.2d 252, 264 (2d Cir.1986), *cert. denied*, 479 U.S. 1046, 107 S.Ct. 910, 93 L.Ed.2d 859 (1987). However, the evidence introduced at trial (as memorialized in the second amended complaint which was amended at the close of plaintiff's case) put Korman on more than adequate notice of this claim. (*See* Olitt Aff. Ex. O at ¶¶ 1, 3, 8, 12, 23, 27, 74, 75, 78, 81, 121, 124.) The evidence showed that Korman was at all times in control of S. Roberts and Jay Vee, that he directed all of their operations, including the prebilling and intercompany transfers, and that he benefited from significant amounts in "loans" from Jay Vee that were subsequently forgiven in Korman's bankruptcy. (*See, e.g.*, Storch Decl. Exs. A-F (PX 206, 207, 210A-S, 216, 558, MC-P), Exs. H-J (PX 36-37, 114 at Schedule F); Tr. 75, 81, 85-86, 110, 113, 145-47, 154, 160, 562, 568, 692-93, 701.) As a rule, "cases should be decided on resolution of the actual dispute between the parties, rather than on the paper pleadings filed at the inception of suit." *Securities and Exchange Commission v. Rapp*, 304 F.2d 786, 790 (2d Cir.1962). Although he was not specifically named on the fraudulent conveyance claim, Korman fully defended himself against that claim at trial and suffered no prejudice from the fact that the question of his liability for it was submitted to the jury.

**\*21** After viewing the evidence in context, the Court finds that Shamis has met his burden of proving that S. Roberts and Korman transferred the S. Roberts inventory to Jay Vee with an actual intent to defraud Wishbone. The jury's verdict against S. Roberts and Korman stands as to the fraudulent conveyance claim.

### 3. Jay Vee

Once a defendant's liability is established, a successor in interest to that defendant is also liable if "(1) it expressly or impliedly assumed the predecessor's tort liability, (2) there was a consolidation or merger of seller and purchaser, (3)

the purchasing corporation was a mere continuation of the selling corporation, or (4) the transaction is entered into fraudulently to escape [the defendant's] obligations." *Schumacher v. Richards Shear Co., Inc.*, 59 N.Y.2d 239, 245, 464 N.Y.S.2d 437, 440, 451 N.E.2d 195 (1983). As stated above, the defendants concede that Jay Vee was formed to carry on the business of S. Roberts, and the trial evidence showed that Jay Vee conducted itself in furtherance of this goal.

Shamis has met his burden of proving Jay Vee's successor liability on two fronts: that Jay Vee was a "mere continuation" of S. Roberts and also that Jay Vee was formed with the express intent of escaping S. Roberts's obligation to Wishbone. The judgment against Jay Vee on the fraudulent conveyance claim stands.

*E. The Punitive Damage Award is Proportionally Reduced to Reflect the Dismissal of the Common Law Fraud Claim*

Punitive damages "are never awarded as of right, no matter how egregious the defendant's conduct," *Smith v. Wade*, 461 U.S. 30, 51, 103 S.Ct. 1625, 75 L.Ed.2d 632 (1983), and in light of this opinion, are possible now in this case only in connection with the fraudulent conveyance claim. Under New York law, punitive damages are not available in the "ordinary" case of fraud, *Smith v. Lightning Bolt Productions, Inc.*, 861 F.2d 363, 371 (2d Cir.1988), and were historically not available in fraudulent conveyance cases except where the fraud was aimed at the general public, was gross and wanton, and involved a high degree of moral culpability. *Walker v. Sheldon*, 10 N.Y.2d 401, 223 N.Y.S.2d 488, 179 N.E.2d 497 (1961).

More recently, courts have begun to recognize the availability of punitive damages under New York law for fraudulent conveyances that are "gross, wanton, or willful" or "morally culpable" even if the fraud does not target the public. *Banco Nacional de Costa Rica v. Bremer Holdings Corp.*, 492 F.Supp. 364 (S.D.N.Y.1980) (denying motion to dismiss plaintiff's claim for punitive damages in connection with state law fraud claims although the fraud was not aimed at the public) (citing *Borkowski v. Borkowski*, 39 N.Y.2d 982, 355 N.E.2d 287, 387 N.Y.S.2d 233 (1976) (mem)). See *Action S.A. v. Marc Rich & Co., Inc.*, 951 F.2d 504, 509 (2d Cir.1991); *Getty Petroleum Corp. v. Island Transportation Corp.*, 878 F.2d 650, 657 (2d Cir.1989).

As described above, defendants' deliberate transfer of inventory from S. Roberts to Jay Vee not only deprived Wishbone of its ability to recover on the millions of dollars in debt S. Roberts owed it, but also led directly to the destruction of Wishbone's business once Wishbone's financial backers withdrew their support due to S. Roberts's failure to repay. The fraudulent conveyance was by definition "willful," and because it "manifests a conscious disregard of the rights of others," *Aniero Concrete Co. v. New York City Construction Authority*, No. 94 Civ. 3506(CSH), 2000 WL 863208,\*28 (S.D.N.Y. June 27, 2000) (quoting *Home Ins. Co. v. American Home Products Corp.*, 75 N.Y.2d 196, 203-04, 551 N.Y.S.2d 481, 550 N.E.2d 930 (1990)), defendants' behavior also exhibits the requisite moral culpability to justify punitive damages.

\*22 The jury's punitive damage award of \$10 million was based upon finding the defendants liable on both the common law fraud claim and the fraudulent conveyance claim. The common law fraud claim has now been dismissed, so the total amount of punitive damages must be reduced accordingly. [FN11] The special verdict form did not ask the jury to specify what proportion of its \$10 million punitive damage award it assessed based on the common law fraud claim and the fraudulent conveyance claim.

FN11. The reduction in punitive damages to reflect the dismissal of the common law fraud claim, as distinguished from a strait reduction of excessive punitive damages, is well within the Court's power. Compare *Spencer v. Casavilla*, 44 F.3d 74, 77 (2d Cir.1994) (noting that the post-trial dismissal of some claims diminished the total punitive damage award) with *Tingley Systems*, 49 F.3d at 96 and *Phelan*, 973 F.2d at 1064 (observing that court should not decrease excessive damages without affording option of new trial).

While there is no mathematical formula for the Court to use in computing punitive damages, such an award must at least bear a reasonable relationship to a plaintiff's injury and defendant's malicious intent. See *Lerman v. Flynt Distributing Co.*, 745 F.2d 123, 141-42 (2d Cir.1984), cert. denied, 471 U.S. 1054, 105 S.Ct. 2114, 85 L.Ed.2d 479 (1985) (libel); *Universal City Studios v. Nintendo Co.*, 615 F.Supp. 838, 863 (S.D.N.Y.1985) (tortious interference with contract), aff'd, 797 F.2d 70 (2d Cir.), cert. denied, 479 U.S.

987, 107 S.Ct. 578, 93 L.Ed.2d 581 (1986). The jury awarded Shamis \$7.2 million in compensatory damages for the common law fraud claim and \$2,656,551 on the fraudulent conveyance claim, for a total compensatory damage award of \$9,856,551. The common law fraud therefore constituted approximately 73% of Shamis's total fraud-induced injuries.

In order to ensure a "reasonable relationship" between the punitive damage award and the injury to Shamis caused by fraud in the remaining claim, the total punitive damage award should be reduced by the 73%, the percentage of the total fraud damages the jury found to result from the common law fraud. When the jury's punitive award is reduced by 73%, the new total punitive damage award becomes \$2,661,268.77.

The jury further found each of the remaining fraud defendants equally liable for punitive damages. As a result, S. Roberts, Jay Vee and Korman will each share equal (33.33%) responsibility for punitive liability, or \$887,089.59.

#### *Conclusion*

For the foregoing reasons, Korman's debt is declared nondischargeable, the verdict on the common law fraud claim is set aside notwithstanding the verdict pursuant to Rule 50, Fed.R.Civ.P., the breach of contract and fraudulent conveyance claims are upheld, and the punitive damage award is proportionately reduced. The defendants' motion for judgment notwithstanding the verdict, new trial, or remittitur of the damages is therefore granted in part and denied in part.

Settle judgment on notice.

It is so ordered.

2000 WL 1368049, 2000 WL 1368049 (S.D.N.Y.)

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